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Board Evaluations: Some New Perspectives

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INTRODUCTION

Board evaluations are now commonplace amongst FTSE 250 and not-for-profit organisations as both regulators and institutional shareholders view board evaluation as a pre-requisite for sound corporate governance. Almost all FTSE 100 companies conduct some form of annual board evaluation and, although more evaluations are conducted using internal resource rather than external advisors, this ratio is shrinking as institutional stakeholders seek an improved objectivity that an external evaluation implies.

A generic process of board evaluation involves some form of mechanical evaluation (e.g. online questionnaires) that allow board members to score themselves and their boards against a number of pre-agreed criteria. These data are frequently supplemented by more qualitative means (e.g. interviews with board members) and the results fed back to board members for action. This begs the question, *'to what extent is this just a perfunctory, annual exercise to fulfil a stakeholder requirement or a real and future-focused initiative to genuinely enhance the performance of the board?'* This short paper, founded on the outputs of recent research, seeks to isolate areas of best practice in board evaluation and to suggest further forms of evaluation that give more meaningful descriptions of board effectiveness.

WHAT TO EVALUATE

There are many and varied models of what boards should seek to evaluate. Some recommend evaluating using a framework of Purpose (e.g. overview of business strategy and its development); Process (e.g. effectiveness of the board's processes and reporting committees); and People (e.g. board composition and succession planning processes). Others use alternative classifications such as Structure and Logistics (e.g. board objectives, remit and terms of reference); Interaction (e.g. relations with shareholders and stakeholders); and Focus (e.g. corporate strategy, governance and risk management). There are a number of questionnaires on the market that aim to assess every dimension of board effectiveness. In this case, less is more. The decision of what to evaluate is restricted by the board's ability to define its own, and then the CEO's, key responsibilities, set annual targets for these and create objective measures to ensure that these have been attained.

Any evaluation should also include an account of the resources that the board needs in order to meet these goals. One framework suggests viewing these in terms of the knowledge, information, power, motivation and time needs of the board set against what is currently available to them. For instance, the skill set required to lead a high street banking organisation prior to 2008 is not the same skill set needed in 2010 and beyond. A well devised board evaluation will help identify the gaps in critical resource.

The outputs of a number of board evaluations are noted in the annual accounts. Some of these are anodyne statements that give an illusion of rigour and compliance where this may not be the case. For example, the Northern Rock annual report and accounts for 2006, published in early 2007, state that, *'the Secretary reported to the board on the outcome of the evaluation exercise, which showed that the board and its committees were discharging their responsibilities effectively'.* Seven months later the board sought liquidity arrangements from the Bank of England.

All of this suggests a need for a greater level of rigour and inquiry in board evaluations. This is in part attributable to the changing nature of board roles. With increased attention on corporate governance, director's roles have become more complex and better remunerated. Investors unsurprisingly want to know what value-add they are receiving for improved salaries and enhanced share option schemes.

For example, to what extent is the board evaluation process picking up on some of the more complex elements of board decision making and functioning? Again, how does the board work effectively with complex and incomplete information? An enhanced board evaluation would thus include some external validation of the board's decision-making processes. Just how much debate is there on key issues? To what extent are views that challenge prevailing board norms entertained and examined? Is boardroom debate truly a rational consideration of all the data and options leading to an optimal decision or are board members flummoxed by complexity and unable to grasp the nature of the business and its competitive environment?

One answer to these questions is to observe the board in action. In this way, the obvious limitations of director self report are overcome. This would involve understanding and measuring communication patterns within the board. At an individual level, who was talking to whom and with what effect? At a team level, to what extent did the board actively discuss issues that had a direct relevance to the key objectives and goals? Such an analysis might determine that some of the board's explicit objectives were overlooked or marginalised in some way as discussion was sidelined onto less critical issues. As one US analyst has noted, *'A great board is magic. It is human chemistry and the right kind of experience – the board that takes a tick in the box mentality and lives by the letter of the law is unlikely to be destined for greatness.'*

WHO TO EVALUATE

Some boards merely concern themselves with undertaking group evaluations and sidestep or ignore individual board director assessments. The first truism of a high performing team is that it must comprise high performing individuals. Individual director evaluation should be the most powerful determinant of who should remain on the board ahead of other considerations such as retirement age or tenure limits. This means evaluating each board member against a set of agreed behavioural criteria and performance standards, therefore helping to dispel the view held by some directors that the first time that they had found out that they were supposed to be doing something was when they were told that they had not done it!

Self appraisal is not enough. Research supports the view that directors rate their own board effectiveness higher when they evaluate individual directors. As a result, one recommended option is to merge anonymised peer evaluations (collated by a lead director or trusted advisor) with more formal evaluations by the CEO, chair and head of governance. The key issue here is to maintain confidentiality throughout the process. Research suggests that it is not a good idea to link evaluation results with director pay as this may undermine teamwork amongst the board. Rather, performance evaluations should be used as part of the decision towards the director's continued tenure as a board member.

FOLLOW THROUGH

Once the board evaluation is complete it should generate a clear picture of board strengths and development areas, both at a team and an individual level. An effective evaluation process will lead to definitive and measurable plans for corrective action including a commitment on behalf of the board to follow through in order that the outcomes of the process lead to measurable improvements in board performance.

So, do board evaluations improve board performance? In summary, an effective board evaluation will enable board members to hold each other accountable for the way in which they work, by creating a clearer focus on goals frequently driven through an improved understanding of the role of the board, its chair and CEO. One of the most reported benefits is a commitment by directors and the CEO to apportion greater time and attention to long term strategy. This objective is frequently enough in itself to justify the process.

TOP TEN TIPS FOR EFFECTIVE BOARD EVALUATION

- Do use the process to improve board performance - do not just tick the boxes
- Do use both quantitative (e.g. questionnaire) and qualitative (e.g. interview) techniques to gather data
- Don't shoot for the moon - only evaluate the board's key responsibilities and measurable outcomes
- Do evaluate the resource available to the board to enable them to achieve these goals
- Do evaluate both individual directors and board performance
- Do take multiple ratings of director performance
- Do maintain appropriate confidentiality throughout the process
- Do commit to follow up on the evaluation outcomes with clear and measurable plans for improved director and board performance
- Do look to evaluate the effectiveness of the dynamics of the board
- Do consider independent evaluators to ensure impartiality

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